

REPORT OF EXAMINATION  
OF THE  
EXACT PROPERTY AND CASUALTY COMPANY  
AS OF  
DECEMBER 31, 2006

Participating State  
and Zone:

California

Filed June 23, 2008

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Los Angeles, California  
June 23, 2008

Honorable Alfred W. Gross  
Chairman of the NAIC Financial  
Condition Subcommittee  
Commissioner of Insurance  
Virginia Bureau of Insurance  
Richmond, Virginia

Honorable Morris Chavez  
Secretary, **Zone IV-Western**  
Superintendent of Insurance  
New Mexico Insurance Division  
Santa Fe, New Mexico

Honorable Steve Poizner  
Insurance Commissioner  
California Department of Insurance  
Sacramento, California

Dear Chairman, Secretary and Commissioner:

Pursuant to your instructions, an examination was made of the

**EXACT PROPERTY AND CASUALTY COMPANY**

(hereinafter also referred to as the Company or EXACT) at its home office located at 4680 Wilshire Boulevard, Los Angeles, California 90010.

**SCOPE OF EXAMINATION**

The previous examination of EXACT was made as of December 31, 2003. This examination covers the period from January 1, 2004 through December 31, 2006. The examination was made pursuant to the National Association of Insurance Commissioners' plan of examination. The examination included a review of EXACT's practices and procedures, an examination of management records, tests and analyses of detailed transactions, and an evaluation of the assets and a determination of liabilities as of December 31, 2006, as deemed necessary under the circumstances.

This examination was conducted concurrently with examinations of EXACT's California parents and affiliates, namely: Farmers Insurance Exchange, Truck Insurance Exchange, Fire Insurance Exchange, Mid-Century Insurance Company, Civic Property and Casualty Company, Neighborhood Spirit Property and Casualty Company, and Farmers Reinsurance Company.

In addition to those items specifically commented upon in this report, other phases of EXACT's operations were reviewed including the following areas that require no further comment: company history; corporate records; fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of company; business in force by states; loss experience; accounts and records; and sales and advertising.

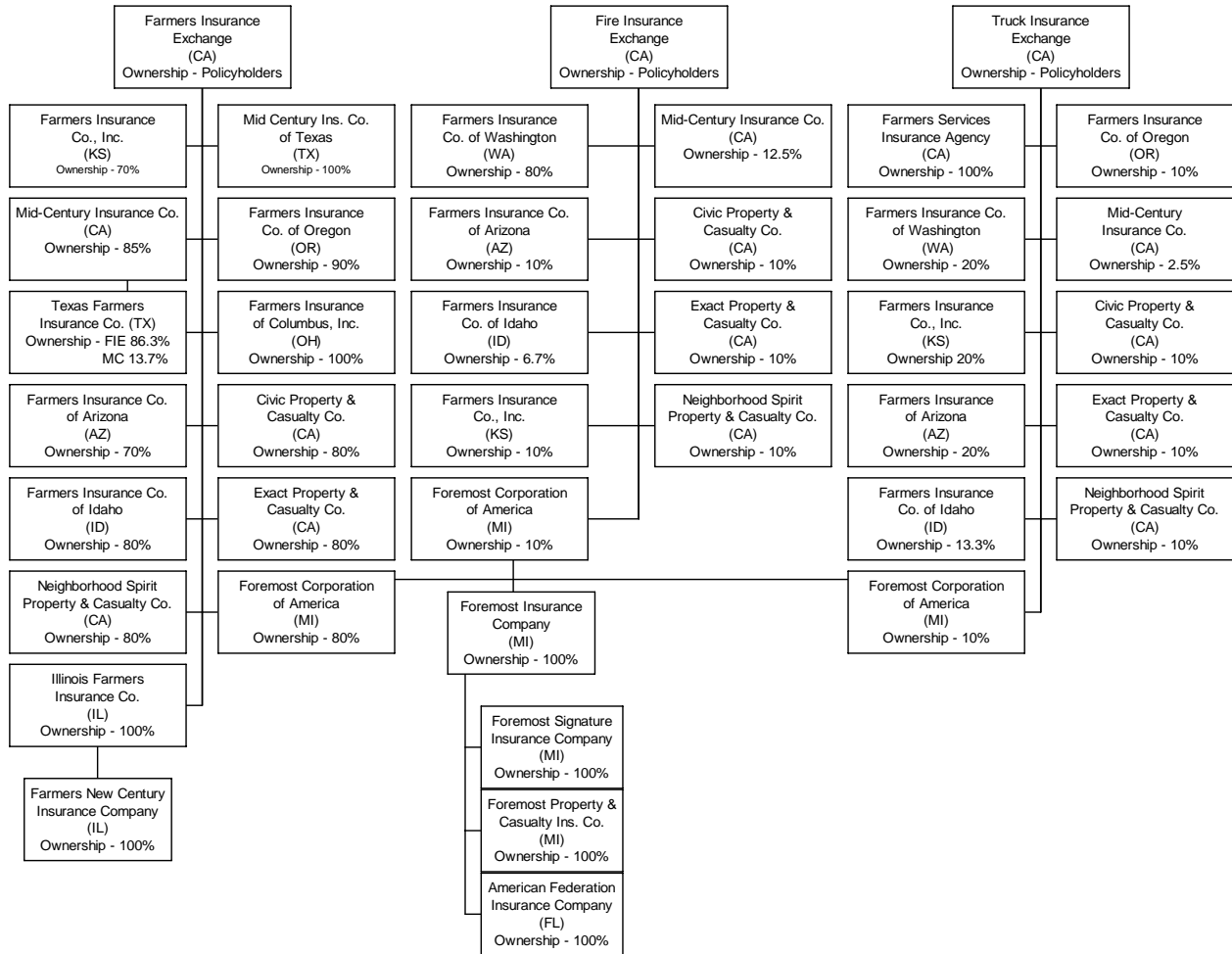
### MANAGEMENT AND CONTROL

The outstanding shares of EXACT were owned by Farmers Insurance Exchange (80%), Fire Insurance Exchange (10%), and Truck Insurance Exchange (10%).

The following abridged organizational charts depict EXACT's relationship within the holding company system both as of December 31, 2006 and as of December 31, 2007:

# FARMERS EXCHANGES

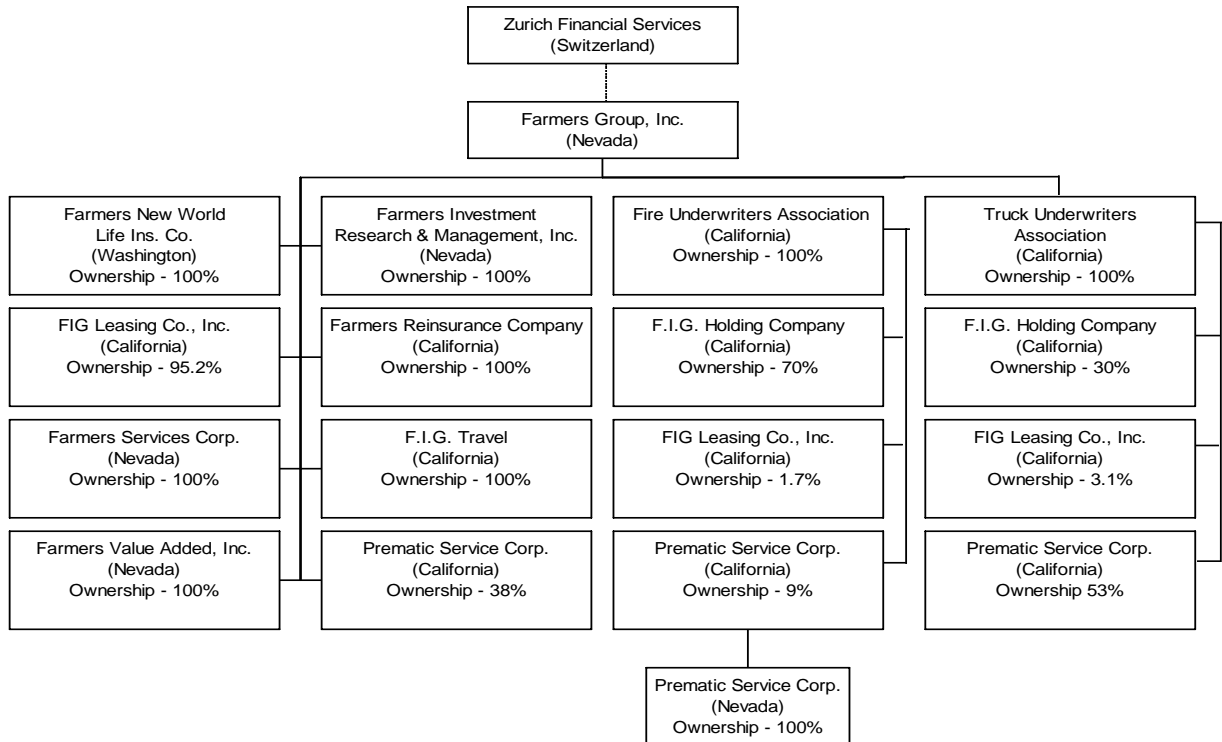
December 31, 2006



(\*) all ownership is 100% unless otherwise noted.

## ZURICH FINANCIAL SERVICES GROUP

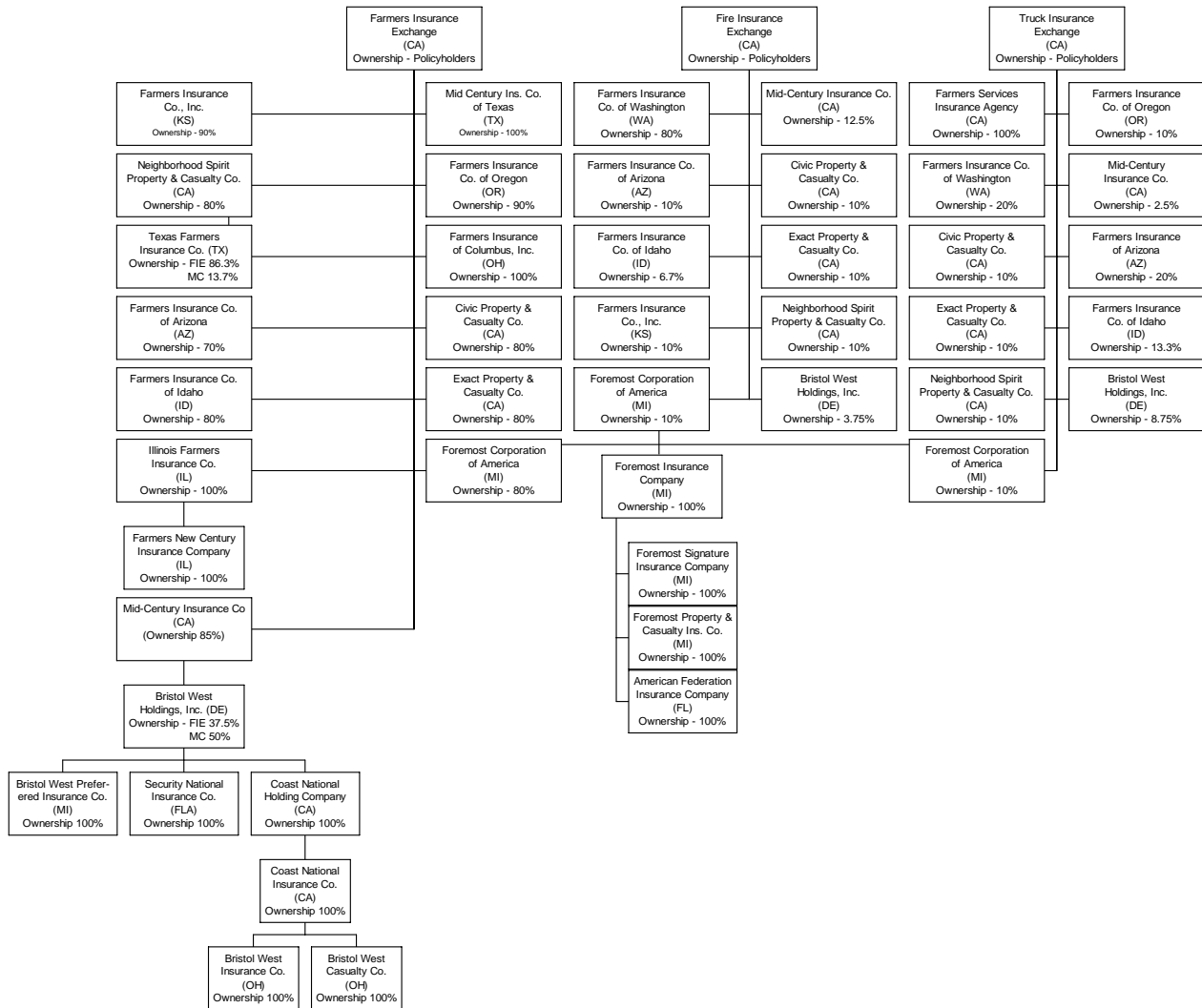
December 31, 2006



(\*) all ownership is 100% unless otherwise noted.

# FARMERS EXCHANGES

DECEMBER 31, 2007



(\* ) all ownership is 100% unless otherwise noted.

Management of EXACT was vested in a seven-member board of directors elected annually. A listing of the members of the board and principal officers serving on December 31, 2006 follows:

Directors

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Paul Norman Hopkins Thousand Oaks, California	Chief Executive Officer and Member of Board of Directors Farmers Group, Inc.
Jason Lawrence Katz Los Angeles, California	Executive Vice President, General Counsel and Member of Board of Directors Farmers Group, Inc.
Kevin Eugene Kelso Los Angeles, California	Senior Vice President and Member of Board of Directors Farmers Group, Inc.
Faye Louise Williams-McClure Pasadena, California	Vice President Farmers Group, Inc.
Keitha Tullos Schofield Los Angeles, California	Executive Vice President and Member of Board of Directors Farmers Group, Inc.
Pierre Christophe Wauthier Agoura Hills, California	Executive Vice President, Chief Financial Officer and Treasurer Farmers Group, Inc.
Frank Robert Woudstra Los Angeles, California	Executive Vice President and Member of Board of Directors Farmers Group, Inc.



### Principal Officers

<u>Name</u>	<u>Title</u>
Faye Louise Williams-McClure	President
Ronald Gregory Myhan	Vice President and Treasurer
Doren Eugene Hohl	Secretary
Paul Norman Hopkins	Vice President
Jason Lawrence Katz	Vice President
Kevin Eugene Kelso	Vice President
Hubert Leslie Mountz	Vice President
Bryan Francis Murphy	Vice President
Mhayse Gokul Samalya	Vice President
Keitha Tullos Schofield	Vice President
Stanley Ray Smith	Vice President
Rubin Snowden	Vice President
Warren Benjamin Tucker *	Vice President
Pierre Christophe Wauthier **	Vice President
Frank Robert Woudstra	Vice President

\* Resigned on May 31, 2007 and was replaced by James Leslie Nutting on June 1, 2007.

\*\* Resigned on October 1, 2007 and was replaced by Scott Lundquist on February 11, 2008.

### Management Agreements

Farmers Group, Inc. (FGI), the Attorney-In-Fact for the three exchanges, provides all operating services, (including staffing and occupancy) except claims adjustment services to EXACT. These services were provided to the three affiliated exchanges pursuant to the subscription agreements signed by each individual policyholder of the exchange(s). There was no such subscription agreement form applicable between EXACT's policyholders and FGI.

There was no existing written management services agreement between EXACT and FGI, the service provider. EXACT's service personnel have indicated that rather than utilizing separate written services agreements, the services and related fees, were anticipated and covered under the broader "due to the reinsurer category" of the inter-company reinsurance pooling agreement. For

2004, 2005 and 2006, the net fees paid by EXACT to FGI as a result of its participation in the intercompany reinsurance agreement were \$15,525,936, \$15,758,084, and \$16,136,064, respectively.

#### Claims Adjustment Services Arrangement

The Farmers Insurance Exchange (FIE) staffs a claims department for the adjustment of its own claims and to adjust certain of its affiliated insurance companies' claims, including EXACT's. The claims adjustment services arrangement in place between FIE and certain of its affiliates (the pooled companies including EXACT), with FIE providing all of their claims adjustment services, was not written. During 2004, 2005, and 2006, net claims adjustment service fees paid by EXACT to FIE as a result of its participation in the intercompany reinsurance agreement were \$8,648,000, \$8,349,000, and \$8,718,000, respectively.

#### Tax Sharing Agreement

EXACT's federal income tax return was consolidated with various insurance and non-insurance affiliates. There was a long-standing written tax sharing agreement in place. The agreement was amended on July 25, 2000 to add Foremost Corporation of America (Foremost) and certain of its subsidiaries, and subsequently amended, effective July 3, 2007, to add Bristol West Holdings, Inc. and all of its subsidiaries, plus two more companies owned by Foremost. The tax allocation was based on separate return calculations with current credit for net losses. On January 3, 2008, the CDI approved this latest amended agreement. EXACT's portion of the federal income taxes paid for 2004, 2005, and 2006, was \$3,826,226, \$3,213,713, and \$4,035,000, respectively.

#### Investment Management Agreements

FGI, acting on behalf of Farmers Insurance Exchange (FIE), Fire Insurance Exchange (Fire), Truck Insurance Exchange (Truck), and the subsidiaries of these three exchanges, including EXACT, entered into an Investment Management Agreement dated July 1, 1998 with its affiliate, Scudder

Kemper Investments Inc. (Scudder). In 2002, Scudder was acquired and replaced by Deutsche Asset Management (DeAM), a division of Deutsche Bank, AG. DeAM, a non-affiliate, managed FIE, Fire, Truck, and their subsidiaries', including EXACT's, fixed income and equity asset portfolios. The terms of the Investment Management Agreement have otherwise not been altered.

FGI was also a party to the Service Level Agreement dated November 4, 1998 with Scudder, which was replaced in 2002 by DeAM. DeAM, a non-affiliate, provided accounting and reporting services in connection with FIE, Fire, Truck, and the stock subsidiaries', including EXACT's investment portfolios, including Securities Valuation Office reporting. DeAM was given the authority to vote the proxies of the common stock. The terms of the Service Level Agreement were left unchanged except for the replacement of parties.

#### Securities Lending Agreement

In 1999 the exchanges and subsidiaries, including EXACT, filed with the CDI a proposed securities lending agreement with its affiliate, Zurich Capital Markets Trust Company (Zurich).

In December 2001, the securities lending agent was changed from Zurich to the Bank of New York Western Trust (BNY), a non-affiliate, as Zurich had decided to exit the securities lending business. "Collateral" as defined in the securities lending agreement between BNY and the companies indicated government securities and cash. The agreement also stipulated that BNY establish a "custodial custody account" in the name of the companies for the purpose of holding collateral and approved investments pertaining to securities lending transactions. The custodian was Wall Street Portfolio Advisors, a division of BNY. The current agreement conformed to the securities lending limits specified in CDI Bulletin 82-2.

## TERRITORY AND PLAN OF OPERATION

EXACT is licensed to transact business in the states of California, Michigan, Missouri, Ohio, and Pennsylvania. EXACT is authorized to write fire, marine, surety, plate glass, liability, workers' compensation, common carrier liability, boiler and machinery, burglary, sprinkler, team and vehicle, automobile, aircraft, and miscellaneous business..

EXACT (together with Civic Property and Casualty Company and Neighborhood Spirit Property and Casualty Company) offers a broad range of personal lines property coverage to "underserved" communities. During 2006, 37.1% of total direct premiums written were in the private passenger auto liability and 26.8% homeowners multiple peril lines of business. The products of these companies are marketed through independent agents. In 2006, EXACT wrote \$13 million of direct premiums. Of the direct premiums written, \$12.8 million (98.5%) was written in California and \$200 thousand (1.5%) was written in the remaining states.

## REINSURANCE

### Intercompany Reinsurance Pooling Agreement

EXACT participated in an intercompany reinsurance pooling agreement. Under this agreement, the affiliated participants ceded all of their business, net of all reinsurance, to the lead company, Farmers Insurance Exchange (FIE). FIE then retroceded a share of the business back to certain participants, including EXACT, based on percentages prescribed under the pooling agreement. The most recent amendment to this long-standing agreement was approved by the California Department of Insurance (CDI) on January 12, 1999. The participants in the intercompany reinsurance pooling agreement, and their respective participation percentages as of December 31, 2006, were as follows:

<u>Pool Participant</u>	<u>Percentage</u>
Farmers Insurance Exchange	51.75
Truck Insurance Exchange	7.75
Fire Insurance Exchange	7.50
Farmers Insurance Company of Oregon	7.00
Farmers Insurance Company of Washington	2.00
Mid-Century Insurance Company	16.00
Texas Farmers Insurance Company	1.00
Farmers Insurance Company, Inc.	0.75
Illinois Farmers Insurance Company	0.75
Farmers New Century Insurance Company	0.75
Farmers Insurance Company of Idaho	0.75
Farmers Insurance of Columbus, Inc.	1.00
Civic Property and Casualty Company	1.00
Exact Property and Casualty Company	1.00
Neighborhood Spirit Property and Casualty Company	<u>1.00</u>
Total	<u>100.00</u>

#### Ceded

#### Affiliated

Treaties ceding quota share risks to affiliated reinsurers were written with FIE and all of its affiliates and subsidiaries (including EXACT) as the cedents, and remained in effect at December 31, 2006. Included was an auto physical damage (APD) 100% quota share agreement with several participants, including the affiliated Zurich Insurance Company (Zurich) with an initial 65% participation and the affiliated Farmers Reinsurance Company (Farmers Re) with a 10% participation. Several non-affiliated reinsurers assumed the remaining 25% in participation. The premium for this APD agreement since 2001 was \$2 billion annually. The APD agreement was approved by the CDI in 2001 for one year, with one-year extensions granted in 2002 and 2003. In 2004, the APD agreement was revised to reduce the quota share percentage to 50%, with Zurich assuming a 40% participation and Farmers Re assuming the remaining 10% participation. Effective January 1, 2006 the above amended APD agreement was replaced by a new APD 100% quota share agreement. The premium

for this replacement APD agreement was \$1 billion annually with Zurich assuming an 80% participation and Farmers Re assuming a 20% participation. The CDI approved this agreement on December 28, 2005.

On December 31, 2002, EXACT along with its property and casualty affiliates (including FIE), entered into a 10% “all-lines” quota share reinsurance agreement ceding business to Zurich and Farmers Re. This agreement covered all lines directly written, assumed from affiliates, or assumed from pools, associations, or syndicates. This agreement was then amended, effective December 31, 2004, to increase the percentage to 12% and amended again effective December 31, 2005, to decrease the percentage down to 6% (Zurich 4.8% participation and Farmers Re 1.2% participation) which was the cession at the examination date. The CDI approved this 2005 amendment on December 28, 2005. Subsequently, the agreement was amended effective December 31, 2007 to decrease the percentage to 5% (Zurich 4% participation and Farmers Re 1% participation) and extend the duration to December 31, 2010. This latest amendment was approved by the CDI on December 28, 2007.

#### Non-affiliated

EXACT, along with its affiliates and subsidiaries, were listed as cedents on various treaties ceding risk on an excess-of-loss basis to non-affiliated reinsurers.

As of December 31, 2006, reinsurance recoverables for all ceded reinsurance totaled \$15.5 million or 22.1% of surplus as regards policyholders. Of the reinsurance recoverables 100% were from admitted affiliates resulting from the pooling arrangement.

## FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2006

Underwriting and Investment Exhibit for the Year Ended December 31, 2006

Reconciliation of Surplus as Regards Policyholders  
from December 31, 2003 through December 31, 2006

Statement of Financial Condition  
as of December 31, 2006

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Note</u>
Bonds	\$ 140,164,928	\$	\$ 140,164,928	
Common stocks	11,472,174		11,472,174	
Cash and short-term investments	15,875,019		15,875,019	
Investment income due and accrued	1,716,442	912	1,715,530	
Premiums and considerations:				
Uncollected premiums and agents' balances in the course of collection	3,852,064	1,001,498	2,850,566	
Deferred premiums, agents' balances and installments booked but deferred and not yet due	19,765,957		19,765,957	
Accrued retrospective premiums	73,629		73,629	
Amounts recoverable from reinsurers	232,040		232,040	
Net deferred tax asset	5,539,649	246,366	5,293,283	
Guaranty funds receivable or on deposit	<u>25,804</u>		<u>25,804</u>	
Total assets	<u>\$ 198,717,706</u>	<u>\$ 1,248,776</u>	<u>\$ 197,468,930</u>	
<u>Liabilities, Surplus and Other Funds</u>				
Losses			\$ 54,766,472	(1)
Reinsurance payable on paid losses and loss adjustment expenses			5,501,189	
Loss adjustment expenses			15,483,167	(1)
Commissions payable, contingent commissions and other similar charges			23,335	
Taxes, licenses and fees			1,567	
Unearned premiums			46,276,154	
Advance premium			1,111,415	
Dividends declared and unpaid: Policyholders			30,000	
Ceded reinsurance premiums payable			612,094	
Payable to parent, subsidiaries and affiliates			1,350,408	
Aggregate write-ins for liabilities			<u>2,294,913</u>	
Total liabilities			127,450,714	
Common capital stock		\$ 5,000,000		
Gross paid-in and contributed surplus		60,000,000		
Unassigned funds (surplus)		<u>5,018,216</u>		
Surplus as regards policyholders			<u>70,018,216</u>	
Total liabilities, surplus and other funds			<u>\$ 197,468,930</u>	



Underwriting and Investment Exhibit  
for the Year Ended December 31, 2006

Statement of Income

Underwriting Income

Premiums earned		\$ 113,908,965
Deductions:		
Losses incurred	\$ 63,189,011	
Loss expenses incurred	12,870,858	
Other underwriting expenses incurred	<u>32,951,144</u>	
Total underwriting deductions		<u>109,011,013</u>
Net underwriting gain		4,897,952

Investment Income

Net investment income earned	\$ 6,740,063	
Net realized capital gains	<u>272,420</u>	
Net investment gain		7,012,483

Other Income

Net loss from agents' or premium balances charged off	\$ (705,998)	
Finance and service charges not included in premiums	258,364	
Aggregate write-ins for miscellaneous income	<u>164,774</u>	
Total other loss		<u>(282,860)</u>
Net income before dividends to policyholders after capital gains tax and before all other federal and foreign income taxes		11,627,575
Dividends to policyholders		52,034
Federal and foreign income taxes incurred		<u>3,910,854</u>
Net income		<u>\$ 7,664,687</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2005		\$ 61,228,471
Net income	\$ 7,664,687	
Change in net unrealized capital gains	606,766	
Change in net deferred income tax	700,704	
Change in nonadmitted assets	(66,998)	
Aggregate write-ins for losses in surplus	<u>(115,414)</u>	
Change in surplus as regards policyholders		<u>8,789,745</u>
Surplus as regards policyholders, December 31, 2006		<u>\$ 70,018,216</u>

Reconciliation of Surplus as Regards Policyholders  
from December 31, 2003 through December 31, 2006

Surplus as regards policyholders, December 31, 2003, per Examination			\$ 40,758,006
	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>	
Net income	\$ 26,763,065	\$	
Change in net unrealized capital gains	1,458,195		
Change in net deferred income tax	1,571,507		
Change in nonadmitted assets		198,011	
Aggregate write-ins for losses in surplus		<u>334,546</u>	
Totals	<u>\$ 29,792,767</u>	<u>\$ 532,557</u>	
Net change in surplus as regards policyholders for the examination			<u>29,260,210</u>
Surplus as regards policyholders, December 31, 2006, per Examination			<u>\$ 70,018,216</u>

## COMMENTS ON FINANCIAL STATEMENT ITEMS

### (1) Losses and Loss Adjustment Expenses

EXACT was directed by the California Department of Insurance (CDI), under California Insurance Code Section 733(g), to retain the American Actuarial Consulting Group, LLC, (AACG) for the purpose of assisting this examination in determining the reasonableness of EXACT's loss and loss adjustment expense reserves. Because the business of the Farmers property and casualty companies was pooled, it was necessary to review the losses on a group-wide basis. Based on the analysis by AACG and the review of their work by a Casualty Actuary from the CDI, EXACT's December 31, 2006 reserves for losses and loss adjustment expenses were determined to be reasonably stated and have been accepted for the purposes of this examination.

## SUMMARY OF COMMENTS AND RECOMMENDATIONS

### Current Report of Examination

None

### Previous Report of Examination

Contingent Liabilities (Page 2): Based on discussions with EXACT's attorneys (and the review of public domain documents and information prepared by EXACT), the examiners were able to obtain an understanding of the volume and range of "class action either claims-related or non-claims-related" lawsuits that the Farmers property and casualty group appeared to be exposed to. However, due to the constraints evident in having access only to "public domain" documents and/or attorney discussion, a sufficiently complete understanding of EXACT's contingent liability exposure was not practical or accomplished. The current examination's review of legal data/documents was limited to "public-domain" only, similar to that of the previous examination.

Management and Control - Management Services Agreement (Page 9): Management services were provided directly to EXACT by an affiliate, or affiliates, with the fees based on percentages of premium. It was recommended that EXACT and the appropriate affiliates enter into a written management services agreements to be submitted to the CDI pursuant to CIC Section 1215.5. EXACT is in the process of developing the agreement to be submitted to the CDI.

Management and Control – Claims Adjustment Agreement (Page 10): The Farmers Insurance Exchange (FIE) staffed a claims department to adjust its own claims and to adjust the claims of certain of its affiliated insurance companies (the other exchanges, and the stock companies including EXACT) for a fee. It was recommended that EXACT and FIE enter into a written claims adjustment services agreement and submit it to the CDI pursuant to CIC Section 1215.5. EXACT is in the process of developing the agreement to be submitted to the CDI.

Federal and Foreign Income Tax Recoverable (Page 20): The examination increased the amount of federal income tax recoverable by \$3,314,976. This was the result of accruing for the tax effect of the higher level of net loss and loss adjustment expense reserves, and the accrual of the Bell and MDL cases, as recorded in the prior examination report. This tax effect amount appeared to qualify for treatment as a Net Operating Loss (NOL) carry back. The EXACT reported amount for Federal and Foreign Income Tax Recoverable/Payable was accepted as reasonable for this examination.

Losses and Loss Adjustment Expenses (Page 20): Based upon an independent actuarial review, EXACT's net loss and loss adjustment expense reserves as of December 31, 2003 were determined to be \$8,426,000 deficient and had been adjusted for the purposes of the examination. Current carried net loss and loss adjustment expense reserves appeared adequate.

Aggregate Write-Ins for Liabilities (Page 21): The amount of "aggregate write-ins for liabilities" per the examination was \$1,968,007 greater than the EXACT stated amount. The current balance carried in aggregate write-ins for liabilities was accepted as reasonable.

## ACKNOWLEDGEMENT

The courtesy and cooperation extended by the EXACT's officers and its parents' employees during the course of this examination are hereby acknowledged.

Respectfully submitted,

/S/  
Gary W. McMurray, CFE  
Examiner-In-Charge  
Contract Insurance Examiner  
Department of Insurance